"TRAINS, LIKE TIME AND TIDE, STOP FOR NO ONE"[1]

Separating skill from luck is an arduous task in periods of enduring abundance. The prolonged growth between the end of the second world war and the end of the 1990s catapulted corporate results to an unimaginable level, resulting in excesses and vanities at the end of this period. Executives wholeheartedly wore their superhero costumes and their biographies were turned into self-congratulatory flyers that described their respective journeys as if they were warriors straight out of a Tolkien epic. They did not know the Talmudic maxim that the wise man is the one who does not speak; for even the wisest of the wise is not free from uttering irrevocable nonsense. The 2008 crisis and other specific mistakes turned many of these pseudo-celebrities into irrelevant footnotes in the arc of history.

Recently, the significant appreciation in technology-linked stocks and the public exposure gained by CEO's through social media has led to a new era of celebrity executives and entrepreneurs. This new generation can be followed through tweets, posts or podcasts – all in real time. They bank on public relations and wave the banner of philanthropy to create the image of a humanized leader imbued with moral principles. While the previous generation of such executives and entrepreneurs would fund museums and libraries, dreaming of having a wing at said institutions named after them, the new generation subconsciously seek the role of God. They focus on saving mankind, either by discovering the elixir of immortality or by taking us in a cinematographic escape *en route* to Mars. The result is a sort of all-encompassing power: In addition to the cheap funding provided by capital markets, the trust of a society enthralled by the quality of the services provided and a "do no evil" mantra is also won. The clients quickly become a loyal flock.

Narratives are the fuel equity markets burn on. Whether it be the story of railways in the 19th century, or the steelworks companies and big industrial conglomerates in the 20th century, successful plots usually promised financial independence for investors and their heirs. However, in the era of exponentiality, potential gains that in the past were left for future generations are quickly appropriated in the present. We may be living through one of the rare historical moments in which the increasing complexity of victorious businesses outpaces the regulator's ability to think through appropriate anti-trust mechanisms.

This explosive combination of fast growth, instant exposure of accomplishments and the democratization of access to capital compounds the possibility of a irrational exuberance. The human characteristic of hyping up successful stories while forgetting failures amplifies the feeling of gain, hypnotizes investors and triggers a kind of gold rush. Theoretically this weakens the incumbents as cheap capital benefits disruption. For the modern entrepreneurs this is the pinnacle of capitalism: with no need for profit or cash generation to underpin the business at present, the most fantastic dream becomes viable as long as it grows and promises an elevated market share in the future. Amidst this context, even the poor and conservative Chinese mothers who previously dreamed of their kids pursuing careers in the stable, state-controlled bureaucracy, now envision a path to salvation through entrepreneurship.

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[1] Jules Verne, French author of "Journey to the Center of the Earth" and "Twenty Thousand Leagues Under the Sea"

"THERE ARE PLACES I'LL REMEMBER ALL MY LIFE / THOUGH SOME HAVE CHANGED / SOME FOREVER, NOT FOR BETTER / SOME HAVE GONE AND SOME REMAIN"[2]

Naturally, this environment of fast changes prompts uproar in the world of investing. The agents run toward new gurus and demand a change of guard. Value investors are questioned and considered a "rearview mirror philosophy". Under such circumstances, it's normal to feel a certain insecurity with the traditional investment process.

The exceptional movement of the S&P index during the past 10 years - with returns highly concentrated in a small subset of technology companies[3] - reinforces the discourse of the enthusiasts of a world in which the conventional measurement of value no longer applies. It is argued that the pace of growth has become the exclusive metric to be observed - even if profitability is delayed to near perpetuity in order to reach high levels of it.

In this scenario, the concept of LTV[4] (-) CAC[5] has been widely employed to define the value of businesses that are less anchored in the present. This is a complex equation to assess. To illustrate, let's suppose a startup is developing a product located in a vertical within a gigantic profit pool. In its first years the business gains traction and speeds up exponentially by delivering a product whose quality or price is significantly better than that of any competitor. In a world without physical barriers, this dynamic advances quickly. CAC is low given that consumers are lured in droves by word of mouth from the early adopters who multiply into an army of unpaid cheerleaders. Meanwhile, LTV may incorporate the possibility of an elevated market share within the product's vertical, or assume the complex hypothesis that the true potential of the startup in question is an elevated share in several related verticals. Since the winner-takes-all narrative is always more seductive, the market tends to recognize and attribute value quickly to the companies with superior quality, as if they were predators capable of building a new Roman Empire.

It would be comfortable to convince ourselves of our incapacity to identify the winners of this new disruption-based environment. However, it may be dangerous for us to hide behind this apparently elegant rationality. Besides the fact that the non-linearity of current businesses creates a very asymmetric payoff structure, one risks losing the capacity to evaluate the hardships that might be effected on incumbents by novel developments. After all, there is no fundamental rule dictating that businesses from the 20th century should migrate to the 21st century with the same level of profitability, or even that they should keep on existing.

The increasingly high valuations of technology companies, the abundance of cash and the current "unicorn zoo" have raised a yellow flag in the corporate establishment. A race has been started seeking innovation-oriented board members, digital transformation directors are in higher demand than water in the desert and seminars promising lessons in disruption have become multimillion-dollar businesses. Leaving aside the irony, this positive panic may speed up significant cultural and operational changes, putting incumbents back in the game. It is not simple to make a goliath move, but the panic of being hit by a David may work miracles.

Walmart, having been through several stages of a company's life cycle, makes for an interesting case study. Built by a visionary founder and having sought differentiation through physical scale advantages, the company reached longevity by illuminating its strategy and culture in an evangelistic cult centered around Sam Walton's persona. Currently, Walmart seeks to adjust to a world of intangible advantages and adapt its old values to a new moment.

[2] Excerpt from the Beatles song "In my life." Written by Lennon-McCartney
[3] As exemplified at the end of Atmos Letter 15: https://bit.ly/30iiIGN
[4] Life Time Value is a metric that estimates the potential present value of a single client throughout his life
[5] Customer Acquisition Cost is the cost of convincing one client to become a consumer of a company's products/services

In this process, the company has absorbed strategic assets[6] without losing the assortment and low cost DNA that drove it until here. It challenges the purist digital model, capitalizing on existing assets to present cheap and practical alternatives for the suburban American middle class such as the in-store pickup of items bought online.

Here in the tropics, the "traditional" Magazine Luiza has also been transitioning to the digital world exceptionally well, utilizing existing assets advantageously. To a certain extent, it has overcome obstacles more competently than its supposedly more modern and 100% digital competitors, converting legacy into opportunity. The challenges the company faces are still broad given that changes in current business dynamics are physical, systems-related and cultural in nature. However, in a continent-sized country with logistical hurdles, by transforming stores and distribution centers into assets instead of liabilities, one starts the race a few steps ahead.

The frenzy currently observed in the investment world stimulates abrupt changes in thought. However, we believe that the complexity inherent to the process of investing implies that one should face this moment as a necessary evolution, controlling the impetus of seeking a revolution. In our view, the essence of the analytical method has not changed. It remains investigative, reflexive, collective and out of equilibrium. Perhaps, it demands an extra touch of creativity to imagine and ponder the future.

Philosophical principles work like a compass: values are crystalized but execution needs adaptation along the way. Therefore, in a world possessing a different payoff structure, with results concentrated in exponential successes or catastrophic losses, it is natural to expect a more diversified portfolio.

Bernard Baruch, one of the great investors of the past century, at the end of his career toyed with the false perceptions held by the public in relation to a life dedicated to a well-defined investment philosophy: “When, as a young man, I started to be successful I was referred to as a gambler. When my operations increased in scope I was referred to as a speculator. And when the sphere of my activities continued to expand, I was referred to as a banker. Actually, I had been doing the same thing all the time.”

“YOU CAN’T TEACH OLD TRICKS TO A NEW DOG”[7]

A decade since the last crisis and influenced by the examples of exponential growth seen recently, the market has never been so fearless when valuing companies featuring superior quality and fast growth. Investors’ capacity to allocate capital efficiently in these businesses involves the correct evaluation of “optionalities” and, despite the risks involved, this exercise becomes fundamental for the construction of differentiated opportunities. This is a challenging task under normal circumstances and it becomes even more complicated in a world where the relevant possibilities are mostly outside of the analyzed companies’ traditional business. Marketplace with payments, software with payments, e-commerce with ads, retail with finance, banking with e-commerce - the list goes on.

In this environment of more hostile and disruptive competition, it is natural that the research process matures in search of a holistic view. This forces us to leave our comfortable sector fiefdoms and more often share internally our research materials, meetings and reflections. The analyst-superstar created inside the specialist concept, religious as to the correlation between effort and knowledge, does not have the necessary tools to evaluate emerging businesses and their complexities. It becomes necessary to reward those who are neither anxious to

[6] Such as Jet.com and Bonobos in the U.S., and Flipkart in India

[7] Atmos’ variation of the traditional pun “You can’t teach an old dog new tricks”

receive recognition nor in a hurry to enrichen themselves quickly, promoting collaborative work within a team of diversified backgrounds and skills. All without forgetting the need to continually seek new tools that emerge with technological evolution and the countless possibilities of analyzing data in more efficient ways than in the past.

Clearly, vertical structures have become anachronistic. It is not enough to be prepared to climb Mount Everest or to spend Gladwell's famous 10,000 hours[8]. Quite the contrary, one needs to be very wary of the risks involved in dealing with too much data and detail in order to avoid an endless information-based scavenger hunt. When the complexity of cases becomes an end in itself, one risks seeing optionality everywhere.

Like a tree born inside a house and shaped by its architecture, we believe that the organic manner in which Atmos' investment process evolved over time facilitates our adaptation to this challenging period. Nonetheless, as with everything pertaining to the future, our reflections are nothing more than conjectures and theories. The battle is only won by the soldiers in the trenches.

"IF YOU WANT TO MAKE GOD LAUGH, TELL HIM ABOUT YOUR PLANS"[9]

The constant need for reflection and adaptation is a painful and time-consuming exercise, and it is not by chance that a portion of the asset management industry addresses this in a pragmatic and irresponsible way. Asset management firms are built by a diversity of funds with different strategies. The managers self-promote themselves and, according to the previous cycle, pitch their most successful fund. The unsuccessful strategies are closed and forgotten. This is an easy tactic to protect oneself from the changes prompted by time, even if it means the client ends up losing. A multiplicity of strategies ensures the manager the eternal comfort that at least one of them will work. It is not necessary to be bold and seek new instruments to navigate different moments of the cycle.

The focus on a single product, coupled with the relevant investment of the partners' personal assets in the fund, does not allow us the luxury of inertia. The only option is to adapt in order to survive.

Since Atmos' inception, we have made our mandate more flexible in order to navigate the storms of Brazil's radical economic cycles. Having initiated the fund in October 2009, shortly after the sharp appreciation that followed the 2008 crisis, in the ensuing years we found an environment that was hostile to investments in Brazilian equities. Although the country was a darling in the emerging markets arena, luring abundant capital towards investment in stocks and leading multiples to sky-high levels, we witnessed local companies investing aggressively in order to seize market share, disregarding the prospective returns pertaining to such a pursuit at that moment in time. In such inebriating times, little attention is paid to the current stage within the cycle and nobody wants to be left outside the party. However, despite the excitement of the guests, when the music stopped playing several investors were still dancing.

During this period, greater portfolio flexibility - through instruments other than traditional stock investments in Brazil - was utilized as a survival tool. Always to minimize risks, but with no vocation to maximize returns. Even if hardly relevant in the construction of historical results, parking capital in alternative assets protected us from making gross mistakes while seeking to complete the portfolio. When exposure to the Real, even at a high nominal interest rate, seemed speculative to us, we set up a structural position in U.S equities and kept our cash in dollars.

[8] Idea introduced by the U.S. writer Malcolm Gladwell in his book "Outliers," in which he explores the theory that 10,000 hours of practice are necessary in order to reach excellence in any activity
[9] Woody Allen

We invested in Brazilian corporate bonds pegged to dollars when the risk-return seemed superior to that of much of the local equities. Additionally, we invested in NTN-Bs when the payoff was superior to investing in businesses with stable cash generation of a similar duration. Furthermore, during much of this period we bought protections when insurance seemed cheap, incorporating the lessons from good old Noah, who built his ark before the storm.

Despite this relative flexibility that we seek to add to portfolio management, historically we have been very resistant towards incorporating a short strategy into our toolkit. The short as an investment instrument has always seemed less intuitive to us due to some particularities: (i) unlimited loss, (ii) adjustment of much of the expected value through borrowing rates, (iii) need to market time - selling "what's going to go down in price" and not necessarily "what is expensive", (iv) danger stemming from the fallacy of strategic value in emerging markets, generally carried out by foreign capital popping up at certain moments in time and paying any price for market share, and (v) potential loss of focus by the team - the intellectual challenge of being right against an irrational market can be seductive, but may generate little value for the portfolio given the limited size of exposure to any given short-case.

However, at an asset management firm that starts its 10th year with zero churn in its employee-base and begins to present greater levels of individual and collective maturity, we believe this may be the moment to reassess some of our previous assumptions in a bid to blaze new trails.

The world has been flush with cash for many years. The strength of this movement increases the multiples paid for traditional companies, just as the risk of disruption looks higher than at any time in the past. In addition, if in the past we joked that stocks climbed higher utilizing the staircase but went down by elevator, today we see the opposite going on. In this new world, where scarcely tested concepts such as LTV (-) CAC are important benchmarks, we have the feeling that investors panic for not owning the successful technology companies of the future, and thus add themselves to the herd. The traditional "panic selling" has become "panic buying" and all this euphoria can create an irrational exuberance as described at the beginning of this letter. The search for returns is so aggressive that certain stocks rise even when companies announce capital increases, or when institutional investors put sizable blocks of stock for sale.

As we venture out on this new path, where the traditional carry of the long strategy is not present, we must be very careful. We can't deny that we are leaving our comfort zone and that some of our prior steps proved less complex. Therefore at the moment our shorts account for less than 5% of the fund. These investments are diversified across three companies and none of these assets possess the exponentiality feature currently craved by investors. As much as prices seem high compared to fundamentals, we remember our incapacity to visualize all possible outcomes. We need to control our rather juvenile yearning for an alternative view and the natural wish to be the first who sounds the alarm call stating that there's "fire on the deck." As the poet Ferreira Gullar once said[10]: "I don't want to be right, I want to be happy!"

[10] José Ribamar Ferreira. Brazilian writer, member of the Brazilian Literature Academy since 2014